Paychex, Inc (PAYX)

Updated June 25th, 2021 by Nathan Parsh

Key Metrics

Current Price:	$106	**5 Year CAGR Estimate:**	3.9%	**Market Cap:**	$37.3 billion
Fair Value Price:	$84	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	7/30/2021[1]
% Fair Value:	126%	**5 Year Valuation Multiple Estimate:**	-4.5%	**Dividend Payment Date:**	8/27/2021[2]
Dividend Yield:	2.5%	**5 Year Price Target**	$113	**Years Of Dividend Growth:**	10
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	6.5%

Overview & Current Events

Paychex, Inc, which was incorporated in 1979, provides payroll accounting, benefits and human resource services to businesses that employ between 10 and 200 employees. Paychex provides services to about 700,000 small and medium-sized businesses, primarily in the U.S. The company operates two segments: Management Solutions, which provides employers with payroll and retirement resources, and PEO and Insurance, which offers outsourced human resource services and insurance.

Paychex announced earnings results for the fourth quarter and fiscal year 2021 on June 25, 2021 (the company's fiscal year ends May 31st). For the quarter, revenue grew 12.6% to $1.03 billion, $50 million above estimates. Adjusted earnings-per-share increased 18% to $0.72, topping expectations by $0.05. For the fiscal year, revenue of $4.06 billion was up slightly compared to the prior year while adjusted earnings-per-share of $3.04 was a 1.3% improvement from the prior year and $0.07 ahead of our estimate.

For the quarter, revenue for the Management Solutions segment grew 14% to $756.4 million. An increase in client base was a major factor in the year-over-year improvement, but this business also saw improvements in HR outsourcing, retirement services and time and attendance. Leadership stated that higher checks per client occurred as customers started to recover from the pandemic. PEO and Insurance Solutions revenue grew 13% to $258.3 million due to higher number of worksite employees and higher margins on state unemployment insurance. Interest on funds held for clients fell 43% to $14.5 million as lower realized gains and lower average interest rates were only partially offset by higher investment balances. Paychex had $1.1 billion in cash and equivalents as of the end of May.

Paychex also provided guidance for the new fiscal year. Revenue is expected to grow at least 7% and adjusted earnings-per-share are anticipated to improve 10% to 12%. We have an initial earnings-per-share target of $3.37 for fiscal year 2022.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$1.51	$1.56	$1.71	$1.85	$2.09	$2.25	$2.45	$2.84	$3.00	$3.04	***$3.37***	***$4.51***
DPS	$1.27	$1.31	$1.40	$1.52	$1.68	$1.84	$2.18	$2.24	$2.48	$2.52	***$2.64***	***$3.37***
Shares[3]	362	365	363	361	360	359	359	359	359	360	***360***	***360***

Paychex saw a slight decline in earnings during the last recession. Considering that the company's revenue largely depends on the number of people on payrolls, Paychex did an admirable job suffering just a slight decline in earnings-per-share as unemployment reached high levels. As long as unemployment is low, Paychex should see earnings continue to grow. If unemployment remains elevated, it is possible that the company could experience a slight reduction in earnings based on how well the company navigated the last recession. Paychex grew earnings at a rate of 8.1% per year

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[1] Estimated ex-dividend date
[2] Estimated dividend payment date
[3] Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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over the past decade. We reaffirm our EPS growth rate to 6% as we believe that Paychex will see meaningful earnings growth rate as recovery from the COVID-19 pandemic takes, place and more employees return to work.

Paychex has increased its dividend for the past 10 years, with an average raise of 8.4% annually over the past 5 years. The company increased its dividend by 6.5% for the 5/27/2021 payment. Shareholders had received the same payment for eight consecutive quarters. With a high dividend payout, we feel that Paychex will need to grow earnings in order to continue growing its dividend.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Avg. P/E	19.6	21.4	24.1	24.8	24.0	26.2	25.1	29.6	24.1	33.3	***31.5***	***25.0***
Avg. Yld.	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	2.5%	***2.5%***	***3.0%***

Shares of Paychex have increased $11, or 11.6%, since our 6/7/2021 update. Based on updated estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 31.5. For context, shares of Paychex have an average P/E of 25.2 over the last ten years. We have raised our target P/E to 25 to be more in-line with the stock's long-term average valuation. If shares were to revert to this target by fiscal 2026, then valuation would be an 4.5% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

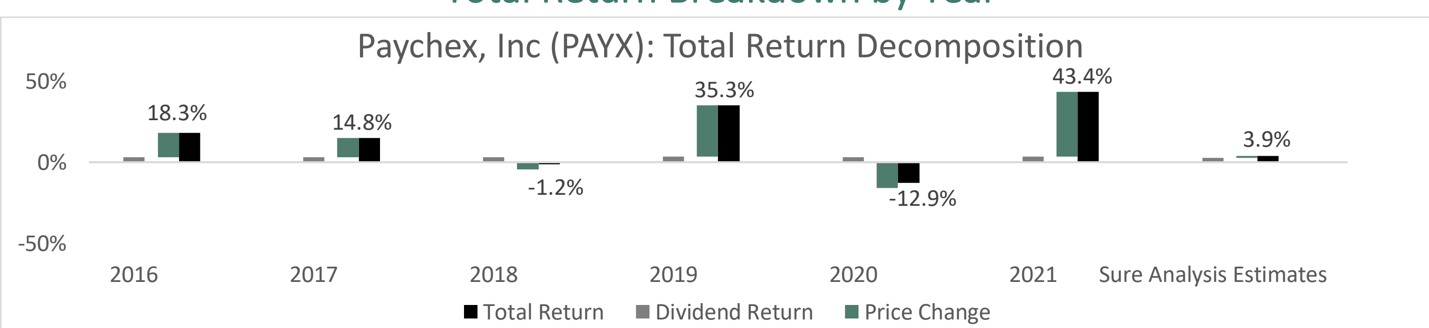
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	84%	84%	82%	82%	80%	82%	82%	79%	83%	82%	***78%***	***75%***

Shares of Paychex weren't immune to lower earnings numbers during the last recession. With that said, the company held up pretty well given the circumstances. Paychex's primary competitive advantage is that it is a leading provider of computerized payroll, account, benefits and human resource services for small and medium sized companies. Another advantage is that Paychex has very little long-term debt on its balance sheet. This allows the company to access debt markets to fund acquisitions.

Final Thoughts & Recommendation

Following fourth quarter results, Paychex is now projected to offer a total annual return of 3.9% through fiscal 2027, up from our previous estimate of 0.6%. We expect that a 6% earnings growth rate and 2.6% dividend yield will be partially offset by a mid-single-digit multiple reversion over the next five years. The company has begun to lap COVID-19 pandemic impacted quarters from the prior year, but still produced higher than expected growth. Both of its business segments had double-digit revenue growth, a positive sign. A lower unemployment rate would likely be a tailwind to the company. We have raised our five-year price target $30 to $113 due to company EPS guidance and a higher target P/E. We raise shares to a hold from a sell previously.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	2,084	2,230	2,326	2,519	2,740	2,952	3,153	3,378	3,773	4,041
Gross Profit	1,433	1,560	1,655	1,786	1,932	2,095	2,234	2,360	2,595	2,760
Gross Margin	68.7%	69.9%	71.1%	70.9%	70.5%	71.0%	70.8%	69.9%	68.8%	68.3%
SG&A Exp.	646	706	750	804	878	948	980	1,068	1,223	1,299
D&A Exp.	89	98	98	105	107	115	127	138	182	210
Operating Profit	786	854	905	983	1,054	1,147	1,254	1,292	1,371	1,461
Operating Margin	37.7%	38.3%	38.9%	39.0%	38.5%	38.8%	39.8%	38.2%	36.3%	36.1%
Net Profit	515	548	569	628	675	757	826	994	1,034	1,098
Net Margin	24.7%	24.6%	24.5%	24.9%	24.6%	25.6%	26.2%	29.4%	27.4%	27.2%
Free Cash Flow	615	617	577	797	792	921	866	1,122	1,148	1,314
Income Tax	277	312	342	361	385	394	433	306	334	339

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	5,394	6,480	6,164	6,370	6,468	6,441	6,834	7,915	8,676	8,551
Cash & Equivalents	119	109	107	153	170	132	185	358	674	905
Accounts Receivable	161	142	133	149	177	409	508	375	421	384
Goodwill & Int. Ass.	591	573	579	581	594	727	715	955	2,182	2,122
Total Liabilities	3,898	4,875	4,390	4,593	4,682	4,529	4,878	5,559	6,057	5,769
Accounts Payable	45	70	43	49	52	57	57	74	76	79
Long-Term Debt	-	-	-	-	-	-	-	-	796	802
Shareholder's Equity	1,496	1,605	1,774	1,777	1,786	1,912	1,955	2,357	2,620	2,781
D/E Ratio	-	-	-	-	-	-	-	-	0.30	0.29

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	9.7%	9.2%	9.0%	10.0%	10.5%	11.7%	12.4%	13.5%	12.5%	12.7%
Return on Equity	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	41.6%	40.7%
ROIC	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	35.8%	31.4%
Shares Out.	362	365	363	361	360	359	359	359	359	360
Revenue/Share	5.75	6.14	6.38	6.88	7.51	8.14	8.70	9.34	10.43	11.19
FCF/Share	1.70	1.70	1.58	2.18	2.17	2.54	2.39	3.10	3.17	3.64

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.